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November 3, 2008

TO: Supervisor Yvonne B. Burke, Chair
Supervisor Gloria Molina
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: Wendy L. Watanabe Wendy L. Watanabe
Acting Auditor-Controller

SUBJECT: **FISCAL REVIEW OF NEW CONCEPT GROUP HOME - A GROUP HOME FOSTER CARE CONTRACTOR**

Attached is our report on the fiscal operations of New Concept Group Home (New Concept or Agency) from January 1, to December 31, 2006. New Concept is licensed to operate one group home (GH) with a resident capacity of eight children. New Concept GH is located in the Second Supervisorial District. New Concept also contracts with Kern County to operate two group homes with a capacity of six children each.

The Department of Children and Family Services (DCFS) and the Probation Department (Probation) contract with New Concept to care for foster children placed in the Agency's home. DCFS paid New Concept $4,479 a month per child, based on a rate established by the California State Department of Social Services. During calendar year 2006, the Agency received $351,262 in GH foster care funds.

Scope

The purpose of our review was to determine whether New Concept complied with its contract terms and appropriately accounted for and spent foster care funds on allowable and reasonable expenditures. We also evaluated New Concept's expenditure and revenue documentation, internal controls and compliance with applicable federal, State and County fiscal guidelines governing GH foster care funds.

Summary of Findings

We identified $57,762 in unallowable and unsupported/inadequately supported costs and $34,819 in excessive compensation. In addition, DCFS and the Agency need to work together to resolve some potential overpayments.

More significantly, New Concept's audited financial statements for 2006 show an operating loss and negative net assets, with $453,243 in "Payroll and Related Liabilities". It is unclear how the Agency will pay these liabilities, since the Agency cannot use current period foster care funds to pay prior period liabilities. New Concept will need to submit a plan to DCFS showing how the Agency will pay these liabilities without using current period foster care funds.

In addition, the Agency needs to develop a cost allocation plan, and strengthen its internal controls over accounting and disbursements, payroll/personnel records, bank reconciliations, and reporting of payments to independent contractors. Details of our findings are discussed in the attached report.

The findings noted in this report are significant and New Concept's corrective action plan needs to address the recommendations in this report. The corrective action plan needs to include how New Concept will provide an adequate quality level of care while addressing their continuing losses. DCFS needs to monitor and ensure that New Concept's corrective actions result in permanent changes.

Further, we have recommended that DCFS determine how much of the questioned costs should be disallowed and collect any overpayments and disallowed amounts.

Review of Report

We discussed our report with New Concept's management on June 5, 2008. The Agency will provide their response to the report to DCFS who will prepare a Fiscal Corrective Action Plan that will be submitted directly to your Board. We thank New Concept's management and staff for their cooperation during our review.

Please call me if you have any questions, or your staff may contact Jim Schneiderman at (626) 293-1101.

WLW:MMO

c: William T Fujioka, Chief Executive Officer
Patricia S. Ploehn, Director, Department of Children and Family Services
Ted Myers, Chief Deputy Director, Department of Children and Family Services
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Board of Directors, New Concept Group Home
Cora Dixon, Bureau Chief, Foster Care Audit Bureau, CA Dept of Social Services
Public Information Office
Audit Committee
Commission for Children and Families

New Concept Group Home
Fiscal Review

REVIEW OF EXPENDITURES/REVENUES

We identified $57,762 in unallowable and unsupported/ inadequately supported costs and $34,819 in excessive compensation. In addition, DCFS and New Concept need to work together to resolve some potential overpayments. Details of these costs are discussed below.

Applicable Regulations and Guidelines

New Concept is required to operate its group homes in accordance with the following federal, State and County regulations and guidelines:

- Group Home Contract, including Exhibit C-2, Auditor-Controller Contract Accounting and Administration Handbook (A-C Handbook)
- Federal Office of Management and Budget Circular A-122, Cost Principles for Non-Profit Organizations (Circular)
- California Department of Social Services Manual of Policies and Procedures (CDSS MPP)
- California Code of Regulations, Title 22 (Title 22)

Unallowable Costs

The Agency paid $45 for a parking violation. Circular Section B.16 states that fines and penalties are unallowable.

Unsupported/Inadequately Supported Costs

A-C Handbook Section A.3.2 states that all expenditures shall be supported by original vouchers, invoices, receipts, contracts or other documentation, and that unsupported expenditures shall be disallowed upon audit. Photocopied invoices or receipts, any internally generated documents (i.e., vouchers, request for check forms, requisitions, canceled checks, etc.), and account statements do not constitute supporting documentation for purchases.

We noted $57,672 in unsupported and inadequately supported expenditures:

- $39,092 in payments to the State Employment Development Department (EDD) on a tax lien for non-payment of State payroll taxes. The Agency did not provide a statement showing the amount of back taxes due, penalties and interest. Without this detailed information we are unable to determine if the payroll taxes are for current or prior contract periods, or the amount of penalties and interest, which are unallowable under the Circular.

- $10,340 in cash payments to the Assistant Executive Director (AED). The Agency did not provide documentation showing how the expenses benefited the group home.

- $6,940 in lease payments and maintenance for a 1996 Ford Club Wagon, which is owned by the AED. The Agency provided a lease agreement costing $500 a month for the vehicle with the AED, who is also the Agency's Treasurer. The lease was only signed by the AED, and we did not see any indication that the lease was approved by the Agency's Board.

  Based on the Kelly Blue Book value, a similar van is valued between $7,100 and $7,900. We believe the four-year lease of a ten-year old van with total payments of $24,000 is not a reasonable expenditure of group home funds.

- $800 paid by check to an independent contractor. The Agency provided an invoice dated two months after the check was cashed.

- $500 payment to the previous Executive Director. Agency management indicated the payment was for a vehicle lease, but did not provide any documentation for the disbursement.

Excessive Salary Compensation

A-C Handbook Section B.3.2 states that salaried employees who work less than full-time (40 hours per week) shall be paid a salary that corresponds with their work schedules. The handbook further states that for purposes of establishing a reasonable level of compensation for Agency personnel, the County may refer to the Child Welfare League of America (CWLA) Salary Study.

The Agency paid two employees $34,819 in excessive compensation as follows:

- The Agency's Executive Director (ED) was paid $75,523 as the ED and $45,665 as an Administrator. The Agency did not provide the employee's authorized salary rates for either position. However, the Agency did provide timecards for all pay periods for both positions. The employee worked approximately 16 hours per week as the ED and approximately 26 hours per week as the Administrator. Based on the CWLA Salary Study for the amount of time worked for each position, the employee was overpaid $26,597 for the ED position.

- The AED was paid $65,163 as the AED and $45,664 as an Administrator. The Agency did not provide the employee's authorized salary rates for either position. The employee worked less than full time for both positions. The employee worked approximately 28 hours per week as AED and approximately 26 hours per week as Administrator. Based on the CWLA Salary Study for the amount of time worked for each position, the employee was overpaid $8,222 for the AED position.

Recommendations

DCFS management:

1. **Resolve the $92,536 ($45 + $57,672 + $34,819) in questioned costs and excess compensation, and collect any disallowed amounts.**

New Concept management:

2. **Ensure that foster care funds are used for allowable expenditures to carry out the purpose and activities of the Agency.**

3. **Maintain adequate supporting documentation for all foster care expenditures, including original itemized receipts/invoices.**

4. **Ensure salary payments are commensurate with the CWLA study or other regionally/nationally accepted salary study for non-profit social service agencies.**

FINANCIAL VIABILITY

The Agency's audited financial statements for 2006 show a $156,179 operating loss and a deficit in net assets of $315,021, largely due to a $453,243 payroll tax liability. We also noted that New Concept had minimal cash and no investments as of December 31, 2006.

The Agency did not provide documentation of the periods to which the delinquent taxes relate. Agency management indicated that they are also in arrears on their federal payroll taxes for 2006 and are waiting for an IRS Agent to be assigned to assist in determining their tax liability. DCFS should require New Concept's management to explain the composition of its payroll tax liabilities by the year in which the liability originated.

To the extent New Concept's payroll tax liabilities originated in prior contract periods, it is unclear how the Agency will pay this liability since the Agency cannot use current period foster care funds to pay prior period liabilities.

New Concept management needs to develop a plan describing how it will continue to provide an adequate level of care while addressing repayment of its liabilities. Given the Agency's tenuous financial position, DCFS must closely monitor New Concept to ensure that service quality is maintained at an acceptable level.

Recommendations

New Concept management:

5. **Provide documentation to DCFS describing the composition of its payroll tax liabilities by the year in which the liability originated.**

6. **Develop a plan demonstrating how it will provide an adequate level of care while repaying its outstanding liabilities.**

7. **DCFS management closely monitor New Concept to ensure that service quality is maintained at an acceptable level.**

POTENTIAL DCFS OVERPAYMENTS

DCFS' records show some potential overpayments. DCFS and New Concept should work together to resolve the overpayments, and DCFS should collect any verified overpayments. New Concept management should ensure that any future payment discrepancies are immediately reported to DCFS and any excess amounts are repaid promptly.

Recommendations

8. **DCFS management work with New Concept to resolve the overpayments and collect any verified amounts.**

9. **New Concept management ensure that any future payment discrepancies are immediately reported to DCFS and excess amounts are repaid promptly.**

CONTRACT COMPLIANCE AND INTERNAL CONTROLS

We noted several contract compliance issues and internal control weaknesses. DCFS should ensure that New Concept management takes action to address the recommendations in this report. DCFS should also monitor to ensure that the actions result in permanent changes.

Cost Allocation

A-C Handbook Section C.1.0 requires contractors to allocate expenditures that benefit multiple programs/funding sources on an equitable basis. New Concept contracts with Kern County and Los Angeles County as a group home provider. However, the Agency does not have a written cost allocation plan. The Agency divided its costs evenly between the contracts, without taking into account the relative cost of each contract. New Concept needs to develop a plan to allocate costs to each funding source on an equitable basis and submit it to the County for review.

In addition, we noted that the Agency charged $318,318 in direct payroll expenses that should have been charged to the Kern County group home contract to the LA County contract. The Agency needs to ensure that all program expenses, including payroll are charged to the correct contract.

Recommendations

10. **New Concept management develop a plan to allocate costs to the Agency's contracts on an equitable basis, and submit it to DCFS for review.**

11. **New Concept management reverse the $318,318 in Kern County salaries charged to Los Angeles County program in the Agency's accounting records, and ensure that all direct program expenses, including payroll, are charged to the correct contract.**

12. **DCFS management evaluate the Agency's cost allocation plan for appropriateness.**

Accounting Procedures and Records

We noted the following weaknesses in New Concept's accounting procedures and records.

- The agency does not have a fixed asset list or conduct an annual inventory. A-C Handbook Section B.4.2 states that contractors must maintain a current list of fixed assets, including the item description, serial number, date of purchase, acquisition cost and source of funds. An inventory of all fixed assets should be conducted at least once each year.

- Four County payments exceeding $500 each were not deposited until 12 to 20 days after they were issued. A-C Handbook Section B.1.2 states that cash receipts totaling $500 or more shall be deposited within one day of receipt.

- The Agency issued a $1,500 check to Smog Pros from their general cash account, and inappropriately charged the expense to the petty cash fund, instead of charging it to the appropriate expense account.

- The Agency's accounting records showed $3,398 in employee advances that had been outstanding for over a year. The Agency's AED indicated that the advances were made to an employee in 2001 and 2002, and that they had been recovered through payroll deductions. However, the repayments had not been recorded in the accounting records. The Agency did not have a personnel file for the employee, nor did they provide us with the payroll registers showing the advances and their subsequent recovery.

Recommendations

New Concept management:

13. Maintain a fixed asset list and conduct an annual inventory at least once a year.

14. Ensure deposits are made as required by the Handbook.

15. Ensure that transactions are appropriately classified in the accounting records.

16. Review the Agency's accounting records and resolve outstanding employee advances.

Disbursement Procedures

We noted the following weaknesses in the Agency's disbursement procedures:

- The Agency did not mark "paid" or reference a check number on 16 of 56 (29%) invoices reviewed. A-C Handbook Section B.2.0 requires that supporting documentation be marked "paid" and referenced to check numbers.

- The Agency made five of 56 (9%) checks payable to "cash". A-C Handbook Section B.2.0 states checks shall not be payable to "cash".

- The Agency's check signer was the sole signer on two checks for $316 and $500 that were payable to herself. The Agency does not require a second signature on checks, regardless of the amount. On checks were the signer is also the payee, a second signer independent of the payee (such as a Board member), should be required to verify the appropriateness of the expense. A-C Handbook Section B.2.0 states that a second signature shall be required on checks, unless otherwise specified in the contract.

Recommendations

New Concept management:

17. **Ensure all invoices are marked "paid" and referenced to a check number.**

18. **Ensure checks are never made payable to cash.**

19. **Require a second signature on all checks were the signer is also the payee.**

Payroll/Personnel Controls

We noted the following internal control weaknesses over payroll and personnel:

- Timecards for three of nine employees were not signed by a supervisor. A-C Handbook Section B.3.1 requires all timecards and time reports be signed in ink by the employee's supervisor.

- Personnel files for two of nine employees (22%) did not have the employee's authorized salary rate. Section B.3.2 further states that personnel and payroll records should include the employee's authorized salary rate.

- The hours paid versus hours worked did not agree for four of nine (44%) employee timecards reviewed. While the dollar amounts were not material, the Agency should review and recalculate timecard hours to ensure each payment is accurate.

Recommendations

New Concept management:

20. **Ensure all timecards are signed by a supervisor.**

21. **Ensure all personnel files contain the employees' authorized salary rate.**

22. **Review all timecards for accuracy prior to processing payment.**

Unreported Independent Contractor's Earnings

A-C Handbook Section A.2.6 requires contractors to comply with all applicable federal and State requirements, including filing 1099s with the taxing agencies. The Agency did not issue 1099s for seven independent contractors.

Recommendation

23. **New Concept management ensure that all payments to independent contractors are properly reported to the taxing agencies.**

Bank Reconciliations

A-C Handbook Section B.1.4 states bank statements should be received and reconciled by someone with no bookkeeping functions. Monthly bank reconciliations should be prepared within 30 days of the bank statement date and reviewed by management for appropriateness and accuracy. The bank reconciliations should be signed and dated by both the preparer and the reviewer. Reconciling items should be resolved timely.

New Concept's bank reconciliations are completed by the Agency's bookkeeper. In addition, the bank reconciliations are not completed timely, are not dated by the preparer or the reviewer, and reconciling items are not resolved timely. For example, the June reconciliation was completed six moths after the bank statement date and the December reconciliation was completed three months after the statement date. The December 2006 reconciliation included a check that was outstanding for 12 months.

Recommendation

24. **New Concept management ensure the Agency's bank account reconciliations are completed by someone with no bookkeeping functions, dated by the preparer and reviewer, completed within 30 days of the bank statement date and outstanding checks are resolved timely.**